This advice should be heeded here. Although the cable industry of 1980 is plainly different from the cable industry of 1993, the consumer benefits of technical dynamism are even more palpable today.

One such palpable example of this "technical dynamism" is Time Warner's 150-channel cable TV system in Queens, N.Y. called "Quantum." Quantum is Time Warner's most advanced cable system which, through the extensive deployment of fiber optics, offers a robust array of pay-per-view options to over 3,000 subscribers.[44] Subscribers to Quantum have been ordering pay-per-view movies from the system's 57 PPV channels at eight times Time Warner's overall PPV movie buy rates and the project has been hailed by many as the beginning of a new phase in cable technology. Time Warner is currently upgrading nine additional systems using this architecture.

Of course, the advancements and benefits inherent in such technically dynamic systems are achieved at substantial costs and risks. The fiber-optic upgrades of the Quantum system, for example, have cost Time Warner $250 per subscriber. And, of course, there was no assurance at the critical decisionmaking time that this investment could be recouped. These risks and costs must caution the Commission against imposing additional and unnecessary regulatory costs which impede technological progress.

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[44] No fewer than 57 of the 150 channels are dedicated to, on average, 15 movies a week. Because of the system's enormous channel capacity, five channels can be devoted to showing a single hit film with staggered start times, so that on one of the channels the film is starting every 30 minutes. The addressable boxes offer viewers menu options on the screen for ordering these movies.

Congress intended for the Commission to avoid resort to rate of return regulation in promulgating its cable rules. First, the Communications Act specifically prohibits such rate of return regulation: "Any cable system shall not be subject to regulations as a common carrier or utility by reason of providing any cable service."[45] In addition, the 1992 Cable Act not only preserves this specific prohibition of rate of return regulation, it also implicitly discredits this regulatory approach by requiring that the Commission's basic service tier regulations "seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission."[46] Since, as the Notice correctly observes, "among the most significant of [rate of return regulation's] disadvantages is that it is neither simple nor inexpensive to administer,"[47] such a regulatory approach plainly must be avoided here as contrary to the statutory scheme.

Finally, the legislative history illustrates Congress' desire to avoid traditional rate of return regulation for the basic service tier:

> The Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone common carriers. <u>It is not the Committee's intention to replicate Title II regulation.</u> The FCC should create a formula that is uncomplicated to implement, administer, and enforce, and should avoid creating a cable equivalent of a common carrier "cost allocation manual."[48]

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[45] Communications Act of 1934 § 621(c).

[46] 1992 Cable Act § 623(b)(2)(A).

[47] Notice at ¶ 33.

[48] House Report at 83 (emphasis added).

To utilize any aspect of rate of return regulation here would be to reinvite the very problems enumerated above and which the Commission has strived so hard to undo over the past twenty-five years. Accordingly, the Commission must eschew any remnant of rate of return regulation to the maximum extent permissible under the statute.

2. Price Cap Regulation Should Be Rejected As a Regulatory Approach for the Basic Service Tier

The Commission also proposes a price cap approach, to be utilized as a means of implementing one of its benchmark alternatives.[49] Time Warner underscores that to the extent these references are to the Commission's existing price cap regimes for telephone regulation, they are as inappropriate as traditional rate of return regulation. Price cap regulation, unless deployed in its purest, theoretical form, can produce many, if not all, of the negative results flowing from rate of return regulation. The Commission has acknowledged that "any final judgment about incentive regulation depends in large measure on the specifics of implementation."[50] The implementation forms which the Commission's telephone price cap regulation have taken do not provide any adequate level of assurance that they could be employed here. There are a number of reasons for this, but primary among them is the inability of the regulator to commit to the price cap regime:

> If the regulated firm believes that the "rules of the game" will be altered based on its performance under those rules, the way it plays the game will be inevitably altered.... It is clear that a regulated firm that believes that the efficiency standard to which

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[49] Notice at ¶¶ 49-52.

[50] Policy and Rules Concerning Rates for Dominant Carriers, 4 F.C.C. Rcd 2873, 2933 (1989).

> it will be held will be raised if it realizes an especially good performance will have reduced incentives to achieve such a performance.... Because the rewards for good performance are reduced, the incentive to perform well will be lessened. At the same time, the inability to commit, by reducing the penalty for poor performance, increases the likelihood that poor performance will occur.[51]

The Commission's efforts to date in Price Caps have failed to sever prices from costs:

> [B]oth common sense and rigorous theory make it clear that as long as the ultimate test for prices is a regulated firm's own costs, ... incentives for efficient operation and innovation will be below competitive levels.[52]

As such, they return telephone consumers, and our economy in general, to many of the costs and inefficiencies which price caps were intended to avoid. Whether or not the deployment of price caps represents an improvement upon earlier telephony regulation, there is little reason to believe that it could improve performance in the cable industry.

3. The Commission Should Adopt a Benchmark Approach to Regulate the Basic Service Tier

The foregoing discussion plainly reveals that the Notice's tentative conclusion to utilize a benchmark approach to basic service tier regulation is necessary and appropriate under the statutory scheme as well as sound public policy.[53] As explained by Dr. Kelley,

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[51] See Statement of Stanley M. Besen, submitted by NCTA in CC Docket No. 87-313 (filed Aug. 3, 1989) at 26.

[52] See R. Schmalensee, The Social Costs of Rate of Return Regulation at 8, filed before the Federal Communications Commission, CC Docket No. 87-313, Appendix B to Comments of AT&T (filed Oct. 19, 1987).

[53] The Act instructs the Commission to "take into account" seven factors in formulating its regulations for the basic service tier. 1992 Cable Act § 623(b)(2)(c). The Notice (continued...)

benchmark regulation is superior to rate of return regulation; it is more efficient, simpler, and more certain.[54] The choice of the benchmark, as well as the procedures deployed to implement and enforce it (whether locally or federally) are all critical to the decision to abjure the costs and complexity of rate of return regulation.

The Notice proposes several alternatives for selecting a benchmark: rates charged by systems facing effective competition, past regulated rates, average recent rates, cost-of-service, and price caps. As is evident from the earlier discussion, Time Warner respectfully submits that the last two alternatives are untenable and at odds with legislative policy. As to the other benchmark alternatives proposed, there may be both conceptual and qualitative problems to their application. As Dr. Kelley concludes, "Although far superior to rate

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[53](...continued) tentatively concludes that Congress intended to afford the Commission considerable discretion in prescribing rules governing the basic service tier. Notice at ¶ 31. <u>See also</u> H.R. Conf. Rep. No. 862, 102d Cong., 2d Sess. 62 (1992)("Conference Report")("Rather than requiring the Commission to adopt a formula to set a maximum rate for basic cable service, the conferees agree to allow the Commission to adopt formulas or other mechanisms and procedures to carry out this purpose."); <u>Broadcast Signal Carriage Issues</u>, Notice of Proposed Rulemaking in MM Docket No. 92-259, FCC 92-499 (released November 19, 1992)("[B]y directing the Commission to "take into account" this and other factors, the 1992 Act appears to leave us considerable discretion in prescribing rules governing recovery of those costs.").

Time Warner fully supports this interpretation of Commission flexibility. Moreover, the adoption of a benchmark approach for regulation of the basic service tier will implicitly "take into account" each of the seven factors enumerated in Section 623(b)(2)(c) and thereby fully discharge any and all obligations the Commission may have in this context.

[54] Kelley at 20.

of return regulation, no benchmark will be perfect."[55] The conceptual problems which inhere in the application of the various benchmarks are detailed by Dr. Kelley.[56]

The actual application of the benchmarks will also pose inevitable and nontrivial measurement problems which, in turn, will require further adjustments. These problems derive from a number of different factors. By way of example only, the basic service tier in 1993 post-Cable Act implementation may bear very little resemblance to the basic tier in 1986 or even 1992. Any system for which the basic tier has remained the same and constant over these time periods is exceptional. Per-channel benchmarks will account for some, but not all of this need for adjustment because per-channel costs often decline as the number of channels rises. Similarly, data which can be confidently used may not be readily available because of the wide variety of marketing approaches utilized to date by the industry. In some cases, equipment charges may have been partially or wholly bundled in with service charges; in other cases, a cable operator may have always charged separately identifiable prices. Because of these and many other measurement problems, Time Warner respectfully reserves comment on the benefits of one benchmark over the other until the industry-wide data submission, and the Commission's proposed uses of it, can be reviewed in detail.

The Notice also proposes as part of the benchmark approach an overall adjustment factor to reflect increases in the costs of doing

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[55] Id. at 23.

[56] See id. at 23-31.

business. As Dr. Kelley explains, one administratively simple approach would be to derive an index using a combination of CPI and a cable entertainment price index.[57] Plainly, such an adjustment is legally required to make the benchmark approach succeed. This approach allows the adjustment to remain simple; the suggestions for other, more complex adjustments to "customize" the benchmark[58] lead the Commission and the industry down the costly path of rate of return regulation, a journey all have agreed is not worth taking.

One other observation is necessary, relating to additional proposals in the Notice regarding price adjustments post-implementation. Both the discussion of the "customization" proposal and the proposal to include a price cap formula as a benchmark regulation component[59] evidence a common concern which, we believe, is unfounded. The apparent concern is that deployment of a nationwide benchmark will drive all cable operators to a common price. In addition, there is a related fear that for operators currently pricing below the benchmark, there would be created an opportunity to "quickly ... raise their rates to that benchmark price."[60] These concerns are unsustainable, especially in light of the entire legislative premise that cable operators have been acting as unregulated monopolies and charging monopoly prices for basic services. Although Time Warner disputes that conclusion, economic learning alone dictates the

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57 Id. at 28.

58 Notice at ¶ 37.

59 Id. at ¶ 34.

60 Id.

presumption that cable companies, like any rational business with or without market power, are charging the profit-maximizing price. Given that fact, a cable operator is hardly able to go from an unregulated environment to a regulated one and suddenly and dramatically raise its prices. Such adjustment factors are simply unnecessary.[61]

For rates which exceed the benchmark, there must also be an opportunity for such cable operators to justify such rates. This requirement is both a matter of fundamental fairness and Fifth Amendment right.

C. Jurisdiction and Procedure for the Basic Service Tier

1. The 1992 Cable Act and the Notice Properly Identify the Primary Jurisdiction of State and Local Authorities in Regulating the Basic Service Tier

Time Warner fully supports the Commission's proposed reading of the jurisdictional division laid out in Sections 623(a)(3-6) to allow local authorities either to regulate basic cable rates or to elect not to regulate in which case the particular cable system would remain unregulated.[62] Under this construction, the Commission has the power to "exercise the franchising authority's regulatory jurisdiction" when a franchise authority certification has been disallowed or revoked by the Commission, and then only until a new certification is approved.[63]

61 See Kelley at 20-21 and n. 31.

62 Notice at ¶ 15.

63 Section 623(a)(2)(A) states, "[T]he rates for the provision of basic cable service shall be subject to regulation by a franchising authority, or by the Commission if the Commission exercises jurisdiction pursuant to paragraph (6)...." 1992 Cable Act § 623(a)(2)(A)(emphasis added). Paragraph (6), entitled "Exercise of Jurisdiction by the Commission," provides (continued...)

The scope of the Commission's authority to regulate directly basic cable rates under the Act is, thus, as the Commission correctly observes, "quite limited," in that unless a franchise authority seeks to assert regulatory jurisdiction over basic cable service, the Commission would have no independent authority to do so.[64]

2. The 1992 Cable Act Does Not and Can Not Serve As an Independent Source for Local Authorities' Power to Regulate the Basic Service Tier

The Notice appears to assume that the Commission could grant to the cities such powers as rate suspension, rejection, and prescription, notwithstanding the real possibility that nothing by way of law or contract gives them such powers. The 1992 Cable Act does not and can not serve as an independent source of authority empowering local governments to regulate basic cable rates. The federal government cannot bestow upon the cities what the states have chosen to withhold from them. Rather, such power may only be granted to the franchising authority by the state or by way of agreement. Local governments are creatures of state law and, as such, possess no inherent power to grant franchises or to regulate.[65] The powers to franchise and to regulate

[63](...continued)
that "the Commission shall exercise the franchising authority's regulatory jurisdiction.... if the Commission disapproves a franchising authority's certification ... or revokes such authority's jurisdiction." Id. at § 623(a)(6)(emphasis added). See also House Report at 81 (explaining that 623(a)(6) "specifies the scope of the FCC's authority to regulate basic cable rates in lieu of a franchising authority.").

[64] Notice at ¶ 15. See also id. at ¶ 87.

[65] 3 Chester James Antineau, MUNICIPAL CORPORATION LAW, § 29.02 (1992)("Antineau"). See also, 1 Ferris, Lloyd, Casey, CABLE TELEVISION LAW, § 13.14-15 (1992).

are state powers which can be extended to municipalities only through an express grant or as an implied product of an express delegation of authority.[66] Such grant of authority generally is found in state statutory or constitutional provisions, or in the terms of local government charters.[67] Absent such a grant, a local franchising authority cannot regulate cable rates.

The text of the 1992 Act supports this interpretation of the jurisdictional division applying to basic service tier regulation. Section 623(a)(3)(B) mandates that local authorities certify to the Commission that they have "the legal authority to adopt" basic service rate regulations. Were the Commission to find that the local franchising authorities' ability to regulate basic rates could derive from the Act, this provision would be rendered meaningless.[68] Similarly, such a finding would also render superfluous Section 623(a)(4)(B) which provides that a certification filed by a franchising authority will not become effective if the Commission finds that "the franchising authority does not have the legal authority" to regulate rates. Legal authority would not be subject to question if the 1992 Act itself were its source. A general rule of statutory construction advises that effect be given "if possible, to every clause

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[66] Antineau, § 29.02.

[67] Id.

[68] Thus, the Commission is quite correct in questioning, "If the Cable Act grants franchising authorities rate regulation powers irrespective of state law, what did Congress intend by enacting Section 623(a)(3)(B)?" Notice at ¶ 20.

and word of a statute."[69] The "effect" of the plain language of these provisions is to undercut any notion that the 1992 Act was intended to provide an independent source for local authorities' power to regulate rates.[70]

Finally, the historical jurisdictional division of cable rate regulation further demonstrates the inability of the 1992 Act to confer authority on local governments to regulate basic service rates. Two decades ago the Commission promulgated rules that attempted to require local authorities to regulate rates for services regularly furnished to all subscribers and included a requirement that local franchising authorities institute programs for rate review and, if necessary, rate adjustments.[71] Eventually, the mandatory aspect of the rule posed problems for local authorities which did not possess authority to

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[69] See Montclair v. Ramsdell, 107 U.S. 147, 152 (1883).

[70] Seen in this light, the Commission's exercise of regulatory authority pursuant to Section 623(a)(6) in a state prohibiting rate regulation by local authorities would not constitute a preemption of state law. The Communications Act contemplates preemption where the law of the State, or franchising authority, or the language of the franchise agreement is inconsistent with the Act. Communications Act of 1934 § 636(c). Here, provisions in state laws which prohibit rate regulation clearly are not inconsistent with the Act. Section 623(a)(6) provides that "the Commission shall exercise the franchising authority's regulatory jurisdiction." As noted above, however, the Act neither mandates that local authorities be granted power to regulate, nor independently empowers them to do so. Thus, in a state that prohibits rate regulation by local authorities, Section 623(a)(6) simply extends to the Commission that which the local franchising body has, namely a rate regulation prohibition. Since the Commission will not have any rights other than those which had been conferred under state law, the state law will not be inconsistent with the Act, and thus preemption will not occur. See Notice ¶¶ 20 and 26.

[71] See Amendment of Rules Relative to Federal, State and Local Relationships in CATV, 36 F.C.C. 2d 143, 204-211 (1972).

regulate rates under state law.[72] In questioning the appropriateness of the rule, the Commission noted:

> Our rules do not, and can not give authority to franchising bodies when that authority does not exist under state law. Rather, our rules and guidelines only apply when and if the authority is exercised pursuant to existing powers.[73]

The federal rule requiring local authorities to regulate rates was thereafter deleted.[74]

3. Franchisee Certification Should be as Streamlined as Possible While Still According Cable Operators Sufficient Notice and Opportunities to Challenge

The Commission proposes a streamlined franchise authority certification procedure.[75] Given the remarkably short time frame set by the statute, the Commission is left with little choice. Time Warner suggests two modifications to the Notice's proposals. First, franchising authorities should be required to advise cable operators, in writing, 10 days before filing with the Commission a request for certification. This will afford the two most interested parties an opportunity to address the matter on an informal basis and perhaps facilitate the resolution of certain issues without imposing any burden on the Commission. It will also enable cable operators to challenge the jurisdiction of the local authority to regulate cable rates

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[72] Amendment of Rules Regarding Regulation of Cable Television System Regular Subscriber Rates, 57 F.C.C.2d 368, 369 (1976).

[73] Id. at 369.

[74] See Amendment of Rules Regarding the Regulation of Cable Television System Regular Subscriber Rates, 60 F.C.C.2d 672 (1976).

[75] Notice at ¶ 19.

(because of either a legal deficiency under 623(a)(3)(A,B) or the presence of effective competition under 623(a)(2)), so these issues may be raised during the certification process.

Second, the appropriateness of the certification itself should be subject to de novo review in a subsequent proceeding. Given the tight schedule mandated by the Act, the Commission must recognize that its certification process during those first 30 days will likely be no more than a ministerial process of receiving paper. It will have no opportunity to review the substance of the representations or the analysis submitted by the certification applications, much less make adverse findings against certification. Thus, the Commission must remain free to review them at a subsequent time without the procedures being impaired by presumptions to which the certification is not entitled.

4. Procedures for Basic Service Tier Regulation Should Be Controlled by Local Franchising Agreements, Subject Only to Their Compliance With the Minimal Procedural Requirements of the 1992 Cable Act

The Commission should adopt procedures for regulating basic cable rates that are as simple and streamlined as the substantive regulations themselves. In this regard, the Commission should not impose on local authorities rigid procedural formulas, especially those predicated on notions of public utility regulation which, for the reasons discussed in section III. B.1., supra, are wholly inappropriate for cable rate regulatory purposes. Instead, the Commission should allow local franchising agreements to control the process, subject only to their compliance with the minimal procedural requirements set forth in the 1992 Cable Act.

The implementation and enforcement sections of the 1992 Cable Act,[76] which instruct the Commission to establish federal procedures to control local rate efforts, by no means require the establishment of any detailed elaboration of administrative tools which the locals would somehow be encouraged, or even compelled, to deploy. Time Warner is most concerned with the suggestions in the Notice that the Commission establish rules for local regulatory procedures analogous to common carrier tariff review procedures to be used for the initial review of basic tier rates and subsequent rate increases.[77] The public interest is disserved by burdening the cable industry and cable consumers with the direct and indirect costs of rate of return regulation. The burdens would also fall upon local governments, many of which are small towns ill-equipped to incur these increased costs. These concerns apply with equal force to the procedural accoutrements of utility regulation. To require as a matter of federal law prior approval from the local government serves no legitimate purpose.

To avoid the substantial risks and costs of rate of return regulation, as well as stay within the bounds of its statutory mandate, the Commission should impose the minimal procedural requirements addressed specifically within the terms of the 1992 Act, and no more. The only procedural requirements and standards the Commission must establish under the Act are set forth in sections 623(b)(5,6) and

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[76] 1992 Cable Act §§ 623(b)(5)-(6).

[77] Notice at ¶¶ 80-83.

623(a)(3)(C).[78] All the Commission must do to fulfill the Act's requirements in this regard is to add the minimal substantive standards required under 623(b)(5)(C) & (D) and 623(b)(6) to the provisions already contained in Commission Rule § 76.33(b)[79]. This revised rule will fully comport with the Act, while also supplying the appropriate tools for implementing the new statutory design.

With respect to the franchise authorities that do have prior approval authority over cable rate increases (by operation of franchise agreement), the Commission should adopt a maximum period of 60 days in which the local authority must act. This timeframe would run from the date of any announced rate increase and any initial rate changes required under implementation of the new Act.[80] In either case, if the

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[78] These sections of the Act require that the Commission promulgate rules governing: how franchisors may enforce cable operator compliance with the basic rate regulation standards (623(b)(5)(A)); how to resolve disputes expeditiously (623(b)(5)(B)); standards to prevent unreasonable charges for subscriber changes to services and/or equipment (623(b)(5)(C)); standards to ensure that subscribers receive notice of the availability of a basic tier (623(b)(5)(D)); 30-day notice requirement of a basic tier price increase (623(b)(6)); and how to afford a reasonable opportunity for consideration of the views of interested parties (623(a)(3)(C)).

[79] 47 C.F.R. § 76.33(b). Tracking the requirements of Section 623(a)(3)(C), this Commission rule provides that in establishing any rate for the provision of basic cable service, a franchising authority must give public notice and opportunity to be heard, as well as issue a formal decision in writing. Under the rule, any party may petition the Commission for special relief.

[80] Time Warner fully supports the Notice's proposal to allow cable operators to pass through certain costs they incur but over which they have no control. Clearly, higher prices induced by the imposition of such costs should not be deemed price "increases" subject to the notice requirement; instead, they should be "passed through without prior regulatory review."
(continued...)

franchise authority fails to reject the initial rate or rate increase within this time period, the rate would become effective. A 60 day period will best promote Congress' dual goals of, on the one hand, providing a "reasonable opportunity for consideration of the views of interested parties"[81] and protecting consumers' interests against potentially unreasonable basic service tier rates,[82] and, on the other hand, fostering expeditious procedures.[83] Moreover, in Time Warner's experience 60 days will provide ample time for the resolution of rate disputes, while not depriving the public of new services for long periods of time.

Regarding the Commission's obligations under Section 623(b)(5)(D), the Notice proposes to model notice requirements upon Rule §76.66(c), the rule governing notice to subscribers of the availability of A/B switches.[84] The proposal to require an initial notice obligation which would repeat annually using "whatever language [cable operators] deem appropriate to convey" the fact that a basic service tier is available,

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[80](...continued)
Notice at ¶ 83. The legislative history supports this direct pass through, as well. See House Report at 82 ("[T]he Committee recognizes that many of the costs involved in the provision of basic service are subject to change.... This subsection is intended to permit the Commission to develop a system of "pass throughs" or other appropriate regulatory mechanisms ... to permit cable programmers to be fairly compensated for the services they provide to cable subscribers and to encourage cable systems to carry such services in the basic tier."). See also Kelley at 23.

[81] 1992 Cable Act § 623(a)(3)(C).

[82] See id. § 623(b)(1); Notice at ¶ 83.

[83] See 1992 Cable Act § 623(a)(5)(B).

[84] Notice at ¶ 89 and n. 122.

implements the statutory requirement and Time Warner recommends its adoption.[85] The Commission should not venture beyond these minimal procedural requirements. Rather, it should allow local franchising agreements to control the regulatory process. This approach is fully consistent with Congressional intent. The Cable Act of 1992 itself requires that the Commission's basic service tier regulations must "seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission."[86] It also prohibits, as it has since 1984, common carrier regulation of cable service offerings.[87] In addition, the "Implementation and Enforcement" Section of the Act itself expressly requires the adoption of procedures that will facilitate the "expeditious resolution" of rate matters.[88] In short, in establishing jurisdiction in the Commission to ensure the reasonableness of basic rates and to supervise, in effect, the reasonableness of the local governments' rate regulatory authority, the 1992 Cable Act seeks merely to confine the local governments' exercise

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[85] Time Warner's comments regarding standards and procedures for charges for changes, i.e., § 623(a)(5)(C), are discussed infra in section VI.

[86] 1992 Cable Act § 623(b)(2)(A).

[87] Communications Act of 1934 § 621(c). See also House Report at 83 ("It is not the Committee's intention to replicate Title II regulation"); Conference Report at 23 (changes to pertinent House and Senate bills in this area were undertaken in conference "to encourage the Commission to simplify the regulatory process.").

[88] 1992 Cable Act § 623(b)(5)(B). The Notice correctly points out Congress' intent to expedite the resolution of rate matters and appropriately rejects the adoption of formal hearings on proposed rate increases or rate-related disputes. Notice at ¶ 85.

of this authority -- but not to formalize it. The Senate Report makes this point directly:

> The Committee also recognizes that franchising authorities have a large stake in the operation of cable systems. The legislation thus permits franchising authorities to retain this authority so long as they abide by the FCC's rules.[89]

Again, Congress intended that these rules not require elaborate or complex procedures. In its cost estimates to the Senate Committee, the Congressional Budget Office asserted that "the requirements in the bill are not likely to result in significant costs for individual jurisdictions."[90] Indeed, only $1-2 million was estimated by CBO to be incurred by franchising authorities nationwide. This surprisingly low figure was based expressly upon the assumption that 60% of these authorities would undertake rate review even under the 1984 Act in light of the Commission's alterations to the "effective competition" standard contained in that Act.[91] Plainly, there was no contemplation of procedures involving such complex matters as rate suspensions, rate rejections, interim prescriptions, final prescriptions, and the time-consuming, elaborate hearing procedures which would lawfully be required to accompany them.

The concept that procedures for basic service would be left predominantly to the local arena is also consistent with prior Commission decisions. For example, in its 1990 Report to Congress, the Commission recommended a procedural framework for cable rate regulation

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89 S. Rep. No. 92, 102d Cong., 1st Sess. 19 (1991)("Senate Report").

90 Id. at 67.

91 Id. at 68.

which looked to local municipalities for the establishment of procedural rules:

> With regard to the ratemaking process where effective competition does not exist, it is our view that federal standards should guide local ratemaking to assure that nonfederal power is exercised reasonably, but the process of rate regulation should be left to municipalities or states. Bifurcation of the standard-setting and rate-setting process between federal and nonfederal jurisdictions will best assure that the regulatory interests of each will be met.[92]

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In sum, the Commission should adopt a simple, easily administered benchmark approach for the regulation of the basic service tier. It should refrain from promulgating elaborate procedures for either its own processes or that of local franchising authorities. Most especially, the proposed tariff review mechanism borrowed from Title II of the Communications Act for the regulation of common carriers is a wholly inappropriate model.

IV. <u>REGULATION OF CABLE PROGRAMMING SERVICES</u>

There is a profound risk in imposing regulatory constraints upon the offering of cable programming services: The enormous wealth of programming, both in terms of quantity and quality, could be substantially curtailed. The dividends which flowed from deregulation under the 1984 Act can be found in news programming (both national and local); first-run entertainment; and special interest or niche programming in areas such as science, children's programming, and fine arts; as well as in locally and nationally produced minority group

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[92] <u>Competition, Rate Deregulation and The Commission's Policies Relating to the Provision of Cable Television Service</u>, 67 Rad. Reg. (P&F) 1771, 1814 (1990).

programming. The unique role which television plays in terms of cultural, social, and political contribution makes these gains all the more important.

The dynamic changes in technology promised for distribution are of equal significance and also were born out of the current unregulated environment. To demonstrate just how dynamic this process is, only two years ago in the Commission's Cable Report proceeding, Time Warner predicted that "54 channel systems are likely to become the industry norm."[93] As discussed supra, with the deployment of optical fiber, systems around the country are beginning to look like Time Warner's Quantum system with over 150 channels. Systems modified with digital compression to derive capacity over 500 channels are planned for availability in less than 12 months.[94] These improvements, involving much investment and risk-taking, are put at risk in a regulated environment.[95] The Commission's unfortunate history of constraining the types of services cable systems may provide, as well as economic rewards which cable operators may seek for their successes in programming, should provide the critical context in which alternative regulatory approaches are evaluated.

The Notice discusses the appropriate standard of reasonableness for cable programming services and whether the standard should be

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[93] Comments of Time Warner Inc. in MM Docket 89-600 (March 1, 1990).

[94] See, e.g., Mark Robichaux, *Need More TV? TCI May Offer 500 Channels*, Wall Street Journal, December 3, 1992, at B1 (describing TCI's plans to introduce digital compression scheme to provide 500 or more cable channels).

[95] See Kelley at 1-5.

different from the basic service tier standard.[96] It appears that the Commission has tentatively concluded to treat basic service rate regulation and upper tier rate regulation the same -- to create a comprehensive rate regulation scheme for both basic and expanded basic services. Time Warner respectfully contends that this approach is contrary to the statutory scheme and legislative history of the Act. Congress did not intend cable programming service regulation as a general comprehensive regulation scheme similar to the basic service rate scheme but rather only as a way to catch the bad actors that charge egregious rates.

A. Components of "Cable Programming Service"

The Cable Act defines "cable programming service" as:

> any video programming provided over a cable system, regardless of service tier, including installation or rental of equipment used for the receipt of such video programming, other than (A) video programming carried on the basic service tier, and (B) video programming offered on a per channel or per program basis.[97]

Thus, as the Notice correctly points out, cable programming service encompasses all "tiered" programming, other than that included in the basic service tier, and excluding all pay-per-channel or per-program material.[98] In this regard, Time Warner fully supports the Notice's proposal to exempt from rate regulation "multiplexed" or time-shifted

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96 Notice at ¶ 91 and n. 127.

97 1992 Cable Act § 623(l)(2).

98 Notice at ¶ 95.

premium services (e.g., HBO1, HBO2, HBO3), to the same extent as traditional single channel premium services.[99]

Further, the Commission must make clear that premium programming services (which, as discussed earlier, are wholly unregulated under the 1992 Cable Act) are not transformed into cable programming services even if they are offered to subscribers on a packaged basis.[100] This construction holds even where a discount for such packages is extended to the subscriber. So long as a channel is available to the same customer on a standalone basis as well as on a packaged basis, its status under the Act remains constant as a wholly unregulated premium programming service. Otherwise the Commission is left with no rational way to determine what is unregulated premium programming and what is tier programming regulable under Sections 623(b) and (c). Plainly, utilizing the current status of cable networks would be bad policy; it would indeed be unworkable, since one operator may tier a network and another offer it as pay programming on a stand-alone basis. In any event, new networks could not be categorized under this scheme.

B. Regulation of Cable Programming Services Should Not Replicate the Comprehensive Basic Service Tier Scheme, But Only Catch "Bad Actors" Charging Egregious Rates

An analysis of the statutory scheme and the legislative history reveals that Congress did not intend to replicate the basic service rate scheme for cable programming services, but intended only to create

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[99] This proposal is fully consistent with the Act's legislative history. See House Report at 80.

[100] See Notice at ¶ 96 and n. 133.

a mechanism to protect against egregious pricing abuse through a complaint mechanism.[101]

The cable programming services rate scheme of Section 623(c) has one major component: a complaint mechanism to identify unreasonable upper tier programming rates in individual cases. In promulgating rules to implement this component the Commission is directed to adopt a minimum showing required for complaints.[102] Thus, Congress merely intended the Commission to bring those unreasonable rates under actual regulation.

Congress' intent of establishing an egregious standard for cable programming services is also fully supported by the legislative history. For example, the House Report states:

> <u>While most cable operators have been responsible about rate increases in this deregulated environment, a minority of cable operators have abused their deregulated status and have unreasonably raised subscribers' rates</u>.... In order to protect consumers, it is necessary for Congress to establish a means for the FCC, in

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[101] The Act requires the Commission to establish criteria for identifying, in individual cases, rates for cable programming services that are unreasonable. 1992 Cable Act § 623(c)(2). In establishing such criteria, the Commission is instructed to "consider" six factors. The Act also permits the Commission to consider other relevant factors. <u>Id.</u> at § 623(c)(1)(A). The Notice tentatively concludes that Congress intended here to accord the Commission "substantial discretion" in establishing the criteria for identifying unreasonable cable programming service rates. Notice at ¶ 91.

Time Warner fully supports this interpretation of substantial Commission discretion. Moreover, the adoption of a mechanism to identify only those cable operators charging egregious rates will implicitly "consider" each of the six factors enumerated in Section 623(c)(2) and thereby fully discharge any and all obligations the Commission may have in this context.

[102] 1992 Cable Act § 623(c)(1)(b).

> individual cases, to identify unreasonable rates and to prevent them from being imposed upon consumers.[103]

Several floor statements of key figures behind the 1992 Cable Act provide additional support for the view that the upper tier rate regulation scheme is only intended to catch bad actors charging egregious rates:

> In addition [to basic tier regulation], S.12 includes what could be called a "bad actor" provision. This bill gives the FCC authority to regulate rates for tiers of programming other than basic, if it receives a complaint that makes a prima facie showing that a particular rate increase is unreasonable, and [t]his will give the FCC the authority to regulate in individual cases where cable operators impose excessive increases on subscribers.[104]

> In addition to [basic rate regulation] the bill includes provisions to rein in the renegades of the cable industry by requiring the FCC, on a per case basis, to regulate unreasonable rate charged for service.[105]

If the Commission adopts a cable programming services rate regulation scheme that brings all services under actual regulation

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[103] House Report at 86 (emphasis added).

[104] 138 Cong. Rec. S.561 (daily ed. Jan. 29, 1992)(statement of Senator Inouye)(emphasis added).

[105] 138 Cong. Rec. E1033 (daily ed. April 10, 1992)(statement of Rep. Markey)(emphasis added). Dr. Kelley endorses this approach, as well: "Under these circumstances, it is reasonable to conclude that Congress intends a limited role for Commission oversight of cable programming services rates. The objective of the 1992 Cable Act with respect to cable programming services, therefore, is to prevent cases of obviously unreasonable cable programming service pricing. A logical target can be established by identifying the "outliers" in the industry. The instrument that is to be used for oversight of cable programming service rates is a case-by-case complaint process triggered only in instances of pricing that deviates substantially from industry norms." Kelley at 13.

similar to the basic service rate scheme, it will supplant Congress' goal of only reining in the cable systems charging egregious rates for upper tier programming.

In addition, a cable programming services rate scheme as comprehensive as the basic rate scheme would risk jeopardizing the quality and quantity of programming, generally. Since deregulation took effect in 1986, the cable industry has substantially invested in programming and other improvements to its systems. These facts have been noted by both Congress and the Commission. The House Report on the 1992 Cable Act states:

> The Committee finds that since deregulation took effect in December 1986, the cable industry, as the Committee hoped, has invested substantially in capital improvements and programming.... Basic cable networks spent $1.5 billion for programming in 1991, an increase from $745 million in 1988, and more than four times the $340 million spent in 1984. Similarly, the typical cable system offers 30 to 53 channels today compared to the typical 24 channels or less before the Cable Act was enacted.[106]

Creating a cable programming services regulatory scheme that brings all services under actual regulation similar to basic rate regulation would put these improvements and the next generation of improvements at substantial risk. As Dr. Kelley observes:

> Given that cable industry economic performance has been quite good along a number of important dimensions, it is all the more important that Commission intervention be designed to accomplish the goals of the 1992 Cable Act with the least possible distortion. Improperly focused or excessive regulation may well slow the obvious progress of the industry, or even reverse the gains.[107]

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[106] House Report at 31.

[107] Kelley at 5.